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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-437

MOBIL OIL CORPORATION, PETITIONER

v.

FEDERAL POWER COMMISSION

No. 73-457

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, PETITIONER

v.

FEDERAL POWER COMMISSION

No. 73-464

MUNICIPAL DISTRIBUTORS GROUP, PETITIONER

v.

FEDERAL POWER COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 5-61)[1] and its order denying rehearing (*id.* at 3-4) are

[1] "Pet. App." refers to the separately bound appendix to Mobil Oil Corporation's petition for a writ of certiorari (No. 73-437).

reported at 483 F. 2d 880. The Federal Power Commission's initial opinion (No. 598, 2 A. 559–750)[2] and its opinion denying rehearing (No. 598–A, 2 A. 865–885), are reported at 46 FPC 86 and 46 FPC 633, respectively.

JURISDICTION

The judgment of the court of appeals (Pet. App. 1–2) was entered on April 16, 1973, and petitions for rehearing were denied on June 11, 1973 (Pet. App. 3–4). On June 18, 1973, Mr. Justice Powell extended the time for filing petitions for writs of certiorari to September 10, 1973. The petitions were filed on September 6, 1973, and September 10, 1973, and were granted on January 14, 1974. The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether the Federal Power Commission properly reopened its producer rate proceeding for the Southern Louisiana natural gas producing area, after the court of appeals had affirmed the Commission's prior rate order in the case but had expressly authorized the Commission to reopen the proceeding if it believed that the public interest would thereby be served.

2. Whether the Commission's rate structure for the Southern Louisiana producing area—including multilevel base ceiling rates, a refund requirement, price and refund-credit incentives for the dedication of new gas reserves to the interstate market, and a mora-

[2] "A." refers to the five-volume appendix in these consolidated cases.

torium on the filing of rate increases—is "just and reasonable" and supported by substantial evidence.

STATUTE INVOLVED

Sections 4, 5, 16, and 19(b) of the Natural Gas Act, 15 U.S.C. 717c, 717d, 717*o*, and 717r (b), are set forth in the appendix to this brief, *infra*, pp. 65–70.

STATEMENT

1. BACKGROUND

In 1954, this Court held in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, that the Federal Power Commission has jurisdiction under the Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.*, to regulate well-head sales by producers of natural gas to interstate pipelines. All rates and charges for such sales were thus required under Section 4(a) of the Act, 15 U.S.C. 717c(a), to be "just and reasonable." The Commission is empowered, under Sections 4 and 5, 15 U.S.C. 717c and 717d, to inquire into the lawfulness of any rate and, in the event it finds a rate unlawful, to determine and prescribe the just and reasonable rate.

For six years following the decision in *Phillips*, the Commission endeavored to regulate the sales of some 2,500 producers by the traditional method of examining each company's costs of service. This process, however, proved administratively unworkable. In 1960, the Commission abandoned the company-by-company approach and undertook instead to determine maximum just and reasonable producers' rates for each of the major gas producing areas. Its au-

thority to set area-wide maximum rates was upheld by this Court in the *Permian Basin Area Rate Cases*, 390 U.S. 747.

In an area proceeding, the Commission considers the costs of service of all the producers in the area, rather than of each producer separately, and it establishes a ceiling on rates that applies to all sales in the area. In setting the area rate structure, however, the Commission does not look solely to the producers' costs of service. As this Court stated in *Permian, supra,* "[t]he Commission cannot confine its inquiries * * * to the computation of costs of service" (390 U.S. at 791). It must, in addition, consider the effect of rates on the future supply of natural gas. "[P]rice can meaningfully be employed by the Commission to encourage exploration and production" (*id.* at 797).

2. SOLA I

There have been two stages to the administrative proceedings in the present case. On May 10, 1961, the Commission instituted a proceeding (*"SoLa I"*) to establish just and reasonable rates for producer sales in the Southern Louisiana area.[3] After extensive hearings, the Commission, on September 25, 1968, issued Opinion No. 546 and an accompanying order (40 FPC

[3] The Southern Louisiana area consists of the southern portion of the State of Louisiana and the state and federal areas of the Gulf of Mexico off the Louisiana coast. The area accounts for about one-third of the Nation's domestic gas production, and has been called "the most important gas-producing area in the country." *Southern Louisiana Area Rate Cases*, 428 F. 2d 407, 418 (C.A. 5), on rehearing, 444 F. 2d 125, certiorari denied, 400 U.S. 950.

530) establishing ceiling rates for gas sold by producers in the area and ordering refunds of rates in excess of the maximum that had been collected by producers prior to the issuance of the Commission's order.

The court of appeals upheld the order. *Southern Louisiana Area Rate Cases*, 428 F. 2d 407 (C.A. 5). It expressed the view, however, that the Commission should give more attention in ratemaking to non-cost factors in order to encourage exploration and assure an adequate supply of natural gas for the future (428 F. 2d at 441–444). The court therefore specified that its affirmance of the Commission's order "should not * * * be interpreted to interfere with Commission action that would change the rates we have approved here" (*id.* at 444–445). The court was aware that the Commission had already "instituted new proceedings to reconsider all major actions it had taken in the orders before us" and "is now holding hearings that will probably result in substantial modifications of the rates set in this case" (*id.* at 421). Indeed, "the existence of the new proceedings * * * has been one of the factors we have considered in deciding to affirm the Commission's decisions" (*id.* at 445).

In response to petitions for rehearing urging that the Commission's authority to modify its order could be exercised only prospectively, the court stated (444 F. 2d 125, 126–127):

> We wish to make crystal clear the authority of the Commission in this case to reopen *any* part of its order that circumstances require be

> reopened. Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so.

With respect to the refunds provided for in the Commission's order, the court stated that if "the refunds are too burdensome in light of new evidence * * * the Commission shall have the power and the duty to remedy the situation by changing its orders" (*id.* at 127).

This Court denied certiorari (400 U.S. 950).

3. SOLA II

The new proceeding to which the court of appeals referred (*"SoLa II"*) was originally limited to the offshore federal domain portion of the Southern Louisiana area (1 A. 2–11) but was expanded, while *SoLa I* was pending in the court of appeals, to include the entire area and virtually all the issues that had been decided in *SoLa I* (1 A. 73–80). On December 24, 1970, the Commission reopened *SoLa I,* ordered it consolidated with *SoLa II,* and directed that a settlement proposal, which had emerged from a conference convened by the Presiding Examiner and which was supported by most of the parties to the proceeding,

be made part of the record of the consolidated proceeding (1 A. 352–354). On July 16, 1971, the Commission issued Opinion No. 598 and an accompanying order (2 A. 559–750), establishing a new rate structure for the Southern Louisiana area superseding the one established in *SoLa I*.

The rate structure was designed to alleviate an increasingly critical gas supply shortage while maintaining reasonable prices (see 2 A. 601–614). It has two central features: base area ceiling rates and a system of incentives. The base rates vary from 21.375 cents to 26 cents per Mcf (thousand cubic feet) according to the "vintage" of the gas (*i.e.*, the date of the contract under which it is delivered)[4] and according to whether it is "onshore" (subject to the Louisiana production tax) or "offshore" (not subject to the tax).[5] The order imposes a moratorium, similar to the one approved by this Court in *Permian, supra,* 390 U.S. at 777–781, on the filing of producer rate

[4] Separate pricing according to vintage was approved in *Permian, supra*, 390 U.S. at 795–799.

[5] The base rates, as summarized in the Commission's opinion (2 A. 592), are as follows:

(1) For Contracts Dated Prior to October 1, 1968:
Onshore—22.375¢
Offshore—21.375¢

(2) For Contracts Dated On or After October 1, 1968:
Onshore—26.0¢
Offshore—26.0¢

The rates for pre-1968 contracts would increase automatically by 0.5¢ on October 1, 1973; the rates for post-1968 contracts would increase automatically by 1.0¢ on October 1, 1974 (*ibid.*).

increases above the applicable area rates (2 A. 651-652).[6]

The Commission also established two incentive programs designed to stimulate exploration and development of natural gas reserves and to encourage new dedications of gas to the interstate market. First, each producer will be entitled to a credit of one cent toward the reduction of its total refund obligation for each additional Mcf of gas dedicated by it to the interstate market between August 1, 1971, and October 1, 1977 (2 A. 592, 654, 666–667). Second, the base area ceiling rates for "flowing" gas (*i.e.*, gas delivered under contracts dated prior to October 1, 1968) will be increased in three stages when area producers as a group have newly dedicated to the interstate market specified amounts of gas reserves prior to October 1, 1977 (2 A. 648–649).[7]

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[6] The moratorium extends to 1976 for pre-1968 contracts, and to 1977 for post-1968 contracts (2 A. 651–652). The Commission's order provides, however, that a producer may apply for a waiver of the moratorium or seek an amendment to the rate structure where such relief can be justified in light of Opinion No. 598 and the accompanying order (2 A. 661).

[7] Ceiling prices on contracts dated prior to October 1, 1968, will be increased as follows: (a) 0.5 cents per Mcf when 7.5 Tcf (trillion cubic feet) of new gas reserves are committed to interstate commerce; (b) an additional 0.5 cents per Mcf when new dedications reach the level of 11.25 Tcf; (c) an additional 0.5 cents per Mcf when new dedications amount to 15 Tcf (2 A. 649). Any new commitments by a producer will first be applied to the reduction of any outstanding refund obligations; only after all its refund obligations have been satisfied or eliminated will the producer's new dedications count toward the contingent escalation levels for the area (2 A. 649, 658).

In addition, the Commission established a schedule of refunds owed by producers who had collected, for gas delivered prior to the effective date of Order No. 598 (August 1, 1971), rates in excess of certain prescribed levels.[8] The Commission estimated that the total refund obligation for Southern Louisiana producers under this schedule is approximately $150 million (2 A. 653, n. 140); the total refund obligation under the *SoLa I* formula (see *ibid.*) was about $375 million (5 A. 237e). No refund obligations were imposed upon producers whose rates during the relevant periods

[8] The rate levels for refund purposes are as follows (2 A. 662):

> (a) For deliveries prior to January 1, 1965, 20.625 cents per Mcf for onshore gas and 19.625 cents per Mcf for offshore gas.
>
> (b) For deliveries from January 1, 1965, to October 1, 1968, 21.25 cents per Mcf for onshore gas and 20.25 cents per Mcf for offshore gas.
>
> (c) For deliveries from October 1, 1968, to January 1, 1971, 30.5 percent of the difference between revenues during this period based on rates prior to October 1, 1970, and the revenues resulting during this period through the application of rates established in Opinion Nos. 546 and 546–A [*SoLa I*], as modified by Opinion No. 567. This percentage factor of 30.5 may be increased as high as 33 percent, in order to bring the refund obligations in this period to within a range of one percent of $150 million dollars.
>
> (d) For deliveries on or after January 1, 1971, base area rates prescribed in [this order].

In its order on petitions for rehearing, the Commission deleted from the last sentence of paragraph (c) the clause beginning with "in order" (2 A. 877). The Commission stated with respect to the period covered by that paragraph that "the calculation of refunds for the period * * * as a percentage of excess collections over Opinion No. 546 rates rather than 100% of a newly established rate for that period provides for an approximate equivalent amount of refunds and is hereby found to be in the public interest" (2 A. 654).

"were collected pursuant to a prior settlement agreement approved by this Commission" (2 A. 662).[9]

The elements of the Commission's order were part of a settlement offer that had broad but not unanimous support among the parties to the proceeding.[10] Although the Commission gave weight to the breadth of the proposal's support,[11] it adopted its terms only after it considered each aspect of the proposal on its merits in light of the evidence (2 A. 594, 601).

On September 9, 1971, the Commission issued Opinion No. 598–A and an accompanying order clarifying its earlier opinion and order and denying rehearing (2 A. 865–885).

4. THE DECISION BELOW

The court of appeals upheld the Commission's orders against a variety of attacks. It held, first (Pet. App. 20–23), that the Commission could properly

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[9] Several producers had entered into company-wide rate settlement agreements, each of which limited the producer's potential refund liability. See, *e.g.*, *Socony Mobil Oil Co.*, 31 FPC 1101, 1105 (Mobil required to pay only "45% of amounts collected above the settlement rates"). A tabulation of settlements is set forth in the opinion of the court of appeals (Pet. App. 46–47, n. 31).

[10] The Commission stated that "the proposal is supported by the overwhelming majority of consumer, pipeline, and producer interests" (2 A. 589). These included 87 gas distribution companies serving about 20 million customers; all the interstate pipelines purchasing gas from the Southern Louisiana area; and 46 natural gas producers, accounting for 80 percent of the area's gas production (*ibid.*).

[11] "[I]ts wide support helps to provide stability in prices in the area and relieve the administrative burdens of the Commission, and to reduce the probabilities of future litigation" (2 A. 601).

adopt, on the basis of an independent consideration of its merits, a rejected settlement offer that had wide support among the affected parties. The Commission "was conscious of its role" (*id.* at 21); it independently found that the plan would result in just and reasonable rates for the area.

The court approved both the design and the price levels of the Commission's rate plan. "We hold that this [rate] structure was amply supported by 'substantial evidence on the record as a whole'" (*id.* at 30).[12] It specifically rejected each of the attacks on the elements of the plan.

(1) Some parties challenged the ceiling rate for "new" gas (*i.e.*, gas delivered under contracts dated on or after October 1, 1968) as inadequate to generate capital for future exploration. The court, however, approved the Commission's cost-based methodology and concluded that the rate for new gas "clearly falls within the 'zone of reasonableness' latitude which Courts must grant to FPC action" (*id.* at 35).[13]

[12] In declining to be drawn into a dispute over whether the Commission must rely on a particular method of determining rates, the court stated (Pet. App. 33, n. 19):

> Because we find FPC's adoption of the terms of the settlement proposed to be supported by "substantial evidence on the record as a whole" we pretermit any further inquiry into the extent to which FPC may abandon or employ the concept of unit costing.

[13] The Commission had concluded that there was a range of reasonable costs that was supported by the evidence in the record; the base rate for new gas was within the range of prices that could be supported by those costs and "at the appropriate level which will elicit exploratory and developmental effort in Southern Louisiana" (2 A. 642). Though it was unable to quantify the precise amount of the new supplies that would be

(2) The court also upheld the ceiling rates for "flowing" gas. It held (*id.* at 32–34) that the Commission could properly determine that the rate for flowing gas should bear part of the cost burden of stimulating new exploration and development. "[W]e cannot ignore FPC's determination that the extra earnings to be acquired through income for flowing gas at the increased rate would generate additional, and needed, internal capital available for expenditure in the search for new gas reserves" (*id.* at 32).

(3) The "contingent escalations" of the price of flowing gas—those that depend upon new area-wide dedications to the interstate market—were challenged on the grounds that they would (a) benefit existing producers unequally and (b) discourage new entrants into the industry because a new producer would have no pre-1968 contracts to which the price escalations would apply. The court held (*id.* at 50) that "an administrative choice is not to be rejected merely because one party may get icing on his cake while another gets only cake." The contingent escalations "program represents a permissible course of action" (*id.* at 51), which the Commission properly found

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elicited as a result of the rate it selected, the Commission concluded that the relationship between price and supply is a positive one (2 A. 620, 623). As the court of appeals put it (Pet. App. 38): "As to defining the rate to supply relationship, FPC said in effect that 'we know that it's positive, but we can't say just how positive.' FPC has to be no more prescient." Since the base rate for new gas "clearly falls within the range of cost estimates which the evidence discloses," it was not necessary for the Commission "to make what would be a necessarily speculative quantification of non-cost elements" (*id.* at 39).

would tend to encourage the commitment of new reserves to the interstate market. As for the new entrant, "we fail to see why he would be in the least bit dissuaded from committing new reserves at 26¢/Mcf by the fact that it might allow some of his competitors to raise their 22.375¢/Mcf flowing gas price by a half-penny" (*ibid.*).

(4) With respect to the refund credit feature of the order, the court recognized (*id.* at 47), as had the Commission (2 A. 600–601),[14] that the producers who had collected the highest rates in the past or who had not yet discharged their previously adjudicated refund obligations would benefit the most from the system. It held, however, that the overall effect of the Commission's order would be to stimulate greater exploration; "we refuse to tamper with an overall program which effectively exploits [the] relationship" between rate and supply, so long as all the producers "get *some* cake" (Pet. App. 45; emphasis in original).[15]

(5) The court also upheld the Commission's moratorium on new filings of rate increases above the area ceiling (*id.* at 51–52), its minimum pipeline prices for transporting liquid and liquefiable hydrocarbons (*id.* at 57), its pricing of casinghead gas on the same basis

[14] The Commission explained that "no [area-wide] scheme can be free of some inequities" (2 A. 601).

[15] The court also held that the Commission's recomputation of producers' refund obligations (see pp. 9–10, *supra*) was not foreclosed by the court's prior affirmance of *SoLa I*, and that the amount chosen was supported by the evidence (Pet. App. 40–45). It rejected contentions that the refund reduction was improper because it benefited some producers more than others (*id.* at 45).

as gas-well gas (*id.* at 53), and its determination of producers' royalty obligations as a fixed element of the costs of service (*id.* at 55–56).[16]

SUMMARY OF ARGUMENT

I

Under Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b), a court of appeals reviewing an order of the Federal Power Commission has "jurisdiction * * * to affirm, modify, or set aside such order in whole or in part." Pursuant to the "equity powers" conferred by that Section, the court "may adjust its relief to the exigencies of the case in accordance with the equitable principles governing judicial action" (*Ford Motor Co.* v. *National Labor Relations Board,* 305 U.S. 364, 373).

The court of appeals in *SoLa I* found no reversible error in the Commission's rate order, but it concluded that the Commission should have an opportunity to determine whether any element of the order should be revised in light of post-record developments indicating an increasingly critical shortage of natural gas supplies. In order "to secure a just result with a minimum of technical requirements" (*ibid.*), the court

[16] A similar rate order for the Texas Gulf Coast producing area was set aside by the Court of Appeals for the District of Columbia Circuit in *Public Service Commission for the State of New York* v. *Federal Power Commission*, 487 F. 2d 1043, pending on petitions for writs of certiorari, Nos. 73–966, 73–967, 73–968, 73–969. That case presents some of the same issues that are presented in this case, and we accordingly suggested in our petition for a writ of certiorari that the Court hold the petitions in that case pending the decision in this case.

affirmed the Commission's order but specifically authorized the Commission to reopen and modify, either prospectively or retrospectively, *any* aspect of the order.

In exercising the authority granted it by the court of appeals, the Commission was not engaged in unlawful retroactive ratemaking. Though the Commission has no power to change finally approved rates retroactively, the *SoLa I* rates, which the court authorized the Commission to revise, were not final.

II

The *SoLa II* rate structure includes base area ceiling rates for new and flowing gas, a formula for computing producer refund obligations, a plan for permitting the discharge of refund obligations through dedications of new gas reserves in lieu of cash payments, a schedule of price escalations for flowing gas contingent upon specified levels of new area-wide dedications, a moratorium on increased rate filings, and a minimum pipeline rate for the transportation of liquid and liquefiable hydrocarbons. The total rate structure and each of its elements are just and reasonable.

1. A reviewing court need not "examine each detail" of a Commission rate order (*Permian Basin Area Rate Cases,* 390 U.S. 747, 767). It need only consider whether the "total effect" of the order has been shown to be "invalid because it is unjust and unreasonable in its consequences" (*Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591, 602).

2. The Commission's rate design and rate levels were adopted from a settlement proposal that most but not all of the parties supported. The Commission accepted the terms of that proposal only after examining each term in light of the evidence of record. It found, on the basis of the evidence, that "the rate design and rate levels recommended therein are just and reasonable" (2 A. 601). It was also influenced, however, and properly so, by the proposal's wide support, which the Commission reasonably believed would lend stability to the area rates (*ibid.*). The Commission gave proper weight to the balance of competing interests reflected in the proposed settlement.

3. The base rate for new gas—26 cents per Mcf—was chosen by the Commission from a range of reasonable costs presented in the record. Though the rate does not include a non-cost incentive to encourage exploration, it is within the permissible zone of reasonableness and is an integral part of the entire rate structure, which provides a sufficient incentive.

The base rate for flowing gas included a non-cost factor designed to facilitate investment in exploration and development efforts. It, too, falls within the zone of reasonableness that reviewing courts accord to the Commission.

The base rates are subject to automatic escalations of a penny for new gas and a half-penny for flowing gas. These were included to take account of anticipated increases in the cost of producing gas.

4. The Commission, in establishing the refund levels for past deliveries of natural gas, properly recognized

that refunds can seriously diminish the capital available to a producer for investment in exploratory ventures. It did not, however, follow its staff's recommendation that no refunds be paid. Instead, it adopted a plan that establishes substantial refund obligations but permits producers to discharge their obligations through commitments of new gas reserves to the interstate market.

The amount of the refund obligation is just and reasonable, and the discharge plan is not unduly discriminatory. Although some producers will not benefit from the refund-credit program, that is a consequence of their own contractual undertakings. Minor inequities are unavoidable in an area rate scheme. So long as they do not result in unreasonably low rates for any producer, they do not invalidate an otherwise proper and effective rate design.

The provision of the order that permits a producer to discharge up to half of his refund obligations to a particular purchaser through dedications of gas to other purchasers fairly balances the competing interests at stake and does not unduly discriminate against consumers.

5. The schedule of contingent escalations in flowing gas prices is a reasonable incentive for industry-wide exploration and development of reserves. Flowing gas revenues are an important source of funds for investments by producers, and the Commission reasonably concluded that the price incentive provided by the contingent escalations would elicit new supplies.

The plan does not unduly discriminate against new entrants. They are principally disadvantaged by their lack of flowing gas revenues and only incidentally by their inability to benefit from the half-penny escalations. The Commission is not restricted to the use of incentives that are applicable to all classes of producers on an identical basis.

6. The moratorium on increased rate filings is a reasonable means of ensuring rate stability where, as here, the order contains automatic and contingent price escalations to account for increasing costs. The Commission's treatment of royalty obligations as a fixed percentage of total costs, its pricing of casinghead gas on the same basis as gas-well gas, and its provisions for minimum pipeline rates for the transportation of liquid and liquefiable hydrocarbons, are reasonable and are supported by substantial evidence.

ARGUMENT

I

THE COMMISSION PROPERLY REOPENED THE SOUTHERN LOUISIANA RATE PROCEEDINGS IN ACCORDANCE WITH THE AUTHORITY CONFERRED UPON IT BY THE COURT OF APPEALS IN "SOLA I"

1. In upholding the Commission's initial rate order in *SoLa I*, the court of appeals was troubled by what it perceived as a failure on the part of the Commission to give sufficient consideration to whether its cost-based rate plan would ensure an adequate supply of natural gas for the future (428 F. 2d at 436–440). The court stated that "the circumstances that have

developed since [the Commission's] decision indicate a possibility, indeed perhaps a certainty, that the supply of gas is dangerously low" (*id.* at 437).

Though the court had "serious misgivings about affirming the Commission" in these circumstances (*id.* at 439), it concluded that "reversal or even a limited remand would serve little purpose in this case," and that "affirmance is the best course" (*ibid.*). The court explained (*ibid.*):

> The Commission has itself recognized the possibility that its prior orders were inadequate and has set new proceedings that will consider precisely the questions troubling us and may well modify the entire scheme here reviewed. If there is a need to do so, the Commission may, and has in part, set aside the present order pending further determination. * * * [W]e think a reversal in this case would unduly interfere with the Commission's performance.

But the court stressed that its affirmance was not to be understood as foreclosing any modification of the terms of the order in the light of changed circumstances or new insights (*id.* at 440):

> [W]e emphasize that our affirmance should not be taken in any manner as a judgment that the supply problem is not serious enough to require immediate modification of the order herein sustained. * * * It is possible that the Commission may find it advisable to make such an immediate modification or that it might set aside the order affirmed here. The Commission has power to take these actions if it finds them appropriate.

In the final section of its opinion, concerning the disposition of the case, the court reiterated that "[t]he mandate of this Court should not * * * be interpreted to interfere with Commission action that would change the rates we have approved here" (*id.* at 444–445).

In petitions for rehearing, some parties urged the court to remand the case to the Commission, because an affirmance would preclude the Commission from modifying the rates for gas already delivered, even if it considered such modification to be necessary in the public interest. The Commission itself, in response to an inquiry by the court, stated that it would not have the authority to order retrospective rate changes after affirmance, unless authorized to do so by the court at the time of the affirmance.[17]

In its opinion on rehearing, the court of appeals clarified its intention with respect to the Commission's authority to modify its *SoLa I* rate order. It stated (444 F. 2d at 126):

> We wish to make crystal clear the authority of the Commission in this case to reopen *any* part of its order that circumstances require be reopened. Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the author-

[17] The Commission's views were set forth in its "Response to Petitions for Rehearing and Request for Remand," reprinted as part of the appendix to the petition for a writ of certiorari of The California Company in the earlier phase of this case (No. 682, O.T. 1970), pp. 51–54.

> ity of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact.

The court specifically stated that adjustments in the rate order could be "retrospective as well as prospective" in accordance with the public interest (*id.* at 126–127).

2. The Commission exercised its authority under the court's judgment to reopen *SoLa I* and to modify the rates established in that case, including the rates for gas already delivered (*i.e.*, the rate levels for computing refund obligations). The Municipal Distributors Group ("MDG") argues (Br. 14–23) that the Commission's reopening of *SoLa I* and its modification of the rate levels for computing refunds "constitute[s] retroactive ratemaking" (Br. 18) which is not authorized by the Natural Gas Act. It contends that the Commission's *SoLa I* order "became final upon [its] unqualified affirmance" by the court of appeals (*ibid.*), and that the court's conferral of authority on the Commission to make prospective or retrospective changes in the order as may be required by the public interest was *ultra vires* and of no effect.

Under Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b), however, the court of appeals has broad authority to take whatever action justice may require with respect to Federal Power Commission orders that it has jurisdiction to review. That Section provides that, upon the filing of a petition to review, the court of appeals "shall have jurisdiction * * * to affirm, modify, or set aside [an] order in whole or in part."

This Court held in *Ford Motor Co.* v. *National Labor Relations Board,* 305 U.S. 364, 373, that, under the nearly identical language of the National Labor Relations Act,[18] "[t]he jurisdiction to review the orders of the Labor Relations Board is vested in a court with equity powers, and while the court must act within the bounds of the statute and without intruding upon the administrative province, it may adjust its relief to the exigencies of the case in accordance with the equitable principles governing judicial action." Though the issue in that case was whether the court of appeals could properly remand a case to the Board, on the Board's motion, for the purpose of setting aside the Board's findings and order, the principles upon which the decision rests are applicable to this case as well.[19] Here, as in *Ford Motor,* the court of appeals' action must be viewed in light of the principle that "[t]he purpose of the judicial review is consonant with that of the administrative proceeding itself,—to secure a just result with a minimum of technical requirements" (*ibid.*).

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[18] Section 10(e) of the National Labor Relations Act. 29 U.S.C. 160(e), provides now as it did at the time *Ford Motor* was decided that, upon the filing of a petition for the enforcement of a Board order, the court "shall have power * * * to make and enter a decree enforcing, modifying, and enforcing as so modified, or setting aside in whole or in part the order of the Board." The court has identical power upon the filing by a person aggrieved of a petition to review a Board order (29 U.S.C. 160(f)).

[19] It has been explicitly recognized that a court of appeals' broad equitable powers under the Natural Gas Act are equivalent to its powers under the National Labor Relations Act. *Natural Gas Pipeline Co.* v. *Federal Power Commission,* 128 F. 2d 481 (C.A. 7).

The court in *SoLa I* fully explained the exigencies of the case. It was troubled by the Commission's failure to give adequate weight to considerations of gas supply; indeed, post-record developments indicated an increasingly critical supply shortage. But, having found no reversible error in what the Commission had done, it decided to leave to the Commission's expert judgment the question of how, if at all, the *SoLa I* rate order should be changed in light of those considerations. It believed that the Commission should have complete flexibility to reopen and reexamine any part of its order, and it believed that a reversal or remand might interfere with the Commission's flexibility. It therefore "adjust[ed] its relief to the exigencies of the case" and reached "a just result with a minimum of technical requirements" (305 U.S. at 373). It affirmed the Commission's order but specifically authorized the Commission to reopen and modify any part of its order that the public interest might require. Its action, we submit, was within its authority as a reviewing court with broad equitable powers.[20]

[20] A similar disposition was ordered in *Dolcin Corp. v. Federal Trade Commission*, 219 F. 2d 742, 750–752 (C.A. D.C.), certiorari denied, 348 U.S. 981. The court there modified an agency order and affirmed the order as modified. It specified, however, that "nothing in this opinion * * * should be read as precluding the Commission from hearing any further evidence in the case * * * which it may wish to consider. * * * If after further hearing the Commission desires to amend its order appropriate steps may be taken looking toward an alteration of our decree, or other proper action on our part" (219 F. 2d at 751). In support of its order denying rehearing *en banc*, a majority of the entire court stated that the panel's action was

3. It follows that the Commission had authority to reopen and modify the *SoLa I* rate order. It is inaccurate to say, as MDG contends (Br. 14), that the Commission's *SoLa II* order "was an unlawful retroactive award of reparations." The Commission, of course, has no power to change finally approved rates retroactively, and it claims none. But where a reviewing court acting pursuant to Section 19(b) of the Natural Gas Act authorizes the Commission to conduct further proceedings with respect to certain rates,[21]

"within our 'equity powers' as a reviewing court" under *Ford Motor* (*id.* at 752).

New York asserts (Br. 17–18) that the court of appeals "does *not* sit as a court of equity in reviewing actions of an administrative agency * * *." But the case it cites for that proposition, *Federal Radio Commission* v. *General Electric Co.*, 281 U.S. 464, is wholly inapposite. The issue there was whether this Court had jurisdiction to review a decision of the Court of Appeals for the District of Columbia setting aside an order of the Federal Radio Commission. This Court held that it did not have jurisdiction, because under the pertinent statute the court of appeals, as a legislative court, was in effect "a superior and revising agency" (281 U.S. at 467). The proceeding in the court of appeals thus "was not a case or controversy in the sense of the judiciary article, but was an administrative proceeding, and therefore * * * the decision therein is not reviewable by this Court" (*id.* at 470).

This Court's statement that the court of appeals in such cases does not exercise "ordinary jurisdiction at law or in equity" (*id.* at 468) refers only to that court's former special role as a legislative court. It does not mean, as New York mistakenly infers, that reviewing courts exercising judicial rather than administrative jurisdiction do not sit as courts of equity. As this Court stated, the jurisdiction of reviewing courts under statutes similar to the Natural Gas Act is "quite unlike the jurisdiction exercised on appeals from the Radio Commission" (*id.* at 470).

[21] Indeed, Section 19(b) specifically authorizes the reviewing court, in appropriate circumstances, to require, rather than (as

those rates are not final and may be revised by the Commission. Cf. *United Gas Improvement Co.* v. *Callery Properties*, 382 U.S. 223, 229; *Tennessee Valley Municipal Gas Association* v. *Federal Power Commission*, 475 F. 2d 446, 452–453 (C.A. D.C.).

4. New York, while expressing "grave doubts" about the authority of the court of appeals to fashion the kind of flexible relief it ordered in *SoLa I* (Br. 17–18), argues only that the Commission's action after reopening did not comport with the literal terms of a portion of the court's opinion on rehearing (Br. 18–26). New York infers from that opinion that the court intended to permit a modification of the refund obligations established in *SoLa I* only upon a Commission finding, based on substantial new evidence, that the refunds "would substantially and adversely affect the producers' ability to meet the continuing gas needs of the interstate market" (Br. 18). It argues that the Commission made no such finding and that the modifications of the refund terms are therefore unauthorized and unlawful.

New York relies solely on the court's statement in its opinion on rehearing that the Commission has the power to modify the *SoLa I* refunds if they "are too burdensome in light of new evidence to be in the public interest" (444 F. 2d at 127). But that phrase was not meant to limit the broad grant of authority con-

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here) merely permit the Commission to consider additional evidence. It provides that upon proper motion by a party, the reviewing court may order additional evidence to be heard by the Commission "upon such terms and conditions as to the court may seem proper."

tained in the prior paragraph, where the court stated that "[t]he Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so" (*id.* at 126-127).

There is no suggestion in the court's opinion that the Commission must make specific findings in the terms stated in the opinion. Indeed, New York's restrictive reading of the opinion is contrary to the court's expressed intention to give the Commission "great flexibility" (*id.* at 126) in determining whether and in what manner the public interest required modification of *any* part of the *SoLa I* order.

Of course, the best judge of the court of appeals' intention in *SoLa I* is the court itself. It is of special significance, therefore, that the court of appeals rejected New York's narrow reading of the opinion on rehearing. It stated in its opinion in this case that "we categorically rejected [in *SoLa I*] the notion that the label 'affirmance' could possibly impair FPC's ability to alter or modify *any* of the provisions, particularly the refund provisions, of its *SoLa I* rate scheme if it believed that the exigencies of the gas industry required more effective remedial measures" (Pet. App. 41–42).

Even if New York's interpretation were the correct one, however, the Commission's opinion in *SoLa II* would satisfy the literal terms of the court's opinion. In its discussion of the amount of refund obligations, the Commission quoted the very sentence of the court's opinion on which New York relies (2 A. 652), and it

found, on the basis of new evidence showing a seriously deteriorating supply situation (2 A. 601–614), that the *SoLa I* rate levels for refund purposes "did not afford an adequate return and * * * understated the requirements for exploration and development" (2 A. 653). It was to correct "these inadequacies" (*ibid.*) that the Commission modified the schedule of refund obligations. In these circumstances, it can fairly be said that the Commission found the *SoLa I* refunds to be "too burdensome" within the meaning of the court of appeals' rehearing opinion.

II

THE COMMISSION'S RATE STRUCTURE FOR THE SOUTHERN LOUISIANA PRODUCING AREA IS "JUST AND REASONABLE" AND SUPPORTED BY SUBSTANTIAL EVIDENCE

A. THE SOUTHERN LOUISIANA RATE PLAN SHOULD BE UPHELD IF IT IS NOT AN ABUSE OF THE COMMISSION'S BOARD REGULATORY AUTHORITY, IF ITS ESSENTIAL ELEMENTS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE, AND IF IT FAIRLY BALANCES THE INTERESTS OF INVESTORS AND CONSUMERS

The Federal Power Commission's basic regulatory responsibility with respect to producer rates within its jurisdiction is to ensure that "[a]ll rates and charges" for the sale of natural gas "be just and reasonable" (Section 4(a) of the Act, 15 U.S.C. 717c (a)). If, after a hearing, it finds any producer rate to be "unjust, unreasonable, unduly discriminatory, or preferential," it must "determine the just and reasonable rate" and "fix the same by order" (Section 5(a), 15 U.S.C. 717d(a)). In the area rate proceedings, the Commission establishes the maximum

just and reasonable rate levels for sales by producers in the area.

The criteria to be applied in reviewing an area rate order are stated in this Court's opinion in *Permian Basin Area Rate Cases,* 390 U.S. 747, which involved the first of the Commission's area rate proceedings. The Court there stated (*id.* at 791–792):

> [T]he responsibilities of a reviewing court are essentially three. First, it must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's esssential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

In carrying out those responsibilities, the court is "not obliged to examine each detail of the Commission's decision" (*id.* at 767). "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry * * * is at an end"; it is then unimportant "that the method employed to reach that result may contain infirmities" (*Federal Power Commission* v. *Hope Natural Gas Co.,* 320 U.S. 591,

602). Moreover, because "Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, * * * [a] presumption of validity * * * attaches to each exercise of the Commission's expertise" (*Permian, supra,* 390 U.S. at 767). Therefore, "he who would upset the rate order under the Act"—by attacking its "total effect"—"carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences" (*Hope Natural Gas, supra,* 320 U.S. at 602).

The Commission's task in ratemaking is to "balanc[e] * * * the investor and the consumer interests" (*id.* at 603); it must "equitably reconcil[e] diverse and conflicting interests" (*Permian, supra,* 390 U.S. at 767). It must, therefore, be accorded great latitude in its rate determinations, and "courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness'" (*ibid.,* quoting from *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U.S. 575, 585).

Finally, this Court does not ordinarily review the correctness of a court of appeals' determination that an agency order is supported by substantial evidence on the record as a whole. That "is a question which Congress has placed in the keeping of the Courts of Appeals" (*Universal Camera Corp.* v. *National Labor Relations Board,* 340 U.S. 474, 491). "This Court will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied" (*ibid.*).

It is in the light of these principles—according broad regulatory discretion to the Commission and allocating principal reviewing authority to the court of appeals—that the Commission's rate order and the court of appeals' affirmance of that order should be viewed.

B. THE COMMISSION PROPERLY ADOPTED THE TERMS OF A WIDELY ACCEPTED SETTLEMENT PROPOSAL AFTER CONSIDERING EACH ELEMENT OF THE PROPOSAL ON ITS MERITS AND DETERMINING THAT THE RATE STRUCTURE IT ESTABLISHED WOULD BE JUST AND REASONABLE

The settlement proposal on which the Commission ultimately based its rate structure for the Southern Louisiana area (2 A. 675–702) was supported by most but not all of the parties to the proceeding (see p. 10, n. 10, *supra*). No party contends that the Commission should have ignored the proposal simply because it lacked unanimous support. Indeed, it is settled that the Commission has a duty to consider even a rejected settlement proposal on its merits. *E.g., Michigan Consolidated Gas Co.* v. *Federal Power Commission,* 283 F. 2d 204, 224 (C.A. D.C.), certiorari denied *sub nom. Panhandle Eastern Pipe Line Co.* v. *Michigan Consolidated Gas Co.,* 364 U.S. 913.

Here the Commission had before it not only the settlement proposal but also the entire *SoLa I* record as well as the extensive record compiled in *SoLa II,* both before and after it was consolidated with the reopened *SoLa I.* The record included substantial evidence concerning the terms of the settlement proposal. As the court of appeals stated (Pet. App. 21),

the Commission "was conscious of its role" in considering the merits of the proposal. It recognized that it could approve the plan "[o]nly if substantial evidence supports it" (2 A. 594) and not merely because it was supported by the "overwhelming majority of consumer, pipeline, and producer interests" (2 A. 589).

The Commission's acceptance of the settlement proposal rests on its determination that "the rate design and rate levels recommended therein are just and reasonable" (2 A. 601). That determination is in turn grounded on "our findings herein, based upon the record evidence in these proceedings" (*ibid.*). That is not to say, however, that the Commission blinded itself to the overwhelming support for the settlement plan. It frankly and properly acknowledged that it was influenced by the existence of that consensus. The proposal's "wide support helps to provide stability in prices in the area and relieve the administrative burdens of the Commission, and to reduce the probabilities of future litigation" (*ibid.*). Thus, as the court of appeals stated (Pet. App. 21): "Obviously, this broad base of support was an important consideration for FPC."

In applying its expert judgment to the difficult task of "reconciling diverse and conflicting interests" (*Permian, supra,* 390 U.S. at 767), the Commission accordingly gave weight to the delicate balance struck by those who supported the settlement proposal. That proposal represented an accommodation of divergent interests "in light of the quasi-bargaining position

of the parties" (2 A. 597). The Commission was entitled to conclude that, since the balance was a proper one and since it would result in just and reasonable area rates, it should not be disturbed.

This is not, as New York argues (Br. 48), an "all or nothing" approach to the settlement proposal. If, in the Commission's judgment, one or more elements of the proposal had lacked substantial supporting evidence, or a particular rate level had been outside the zone of reasonableness, the Commission would have made the appropriate modifications in the proposal's terms. That the Commission in fact found the rate design and rate levels to be just and reasonable is no reason to assume that it was inflexibly committed to the entire settlement package regardless of the individual merits of its terms.

C. THE BASE RATE LEVELS ESTABLISHED BY THE COMMISSION ARE WITHIN THE ZONE OF REASONABLENESS

1. New gas.

The Commission considered in detail the extensive record evidence concerning costs of service (2 A. 630–642). It stated, however, that "cost calculations cannot be mathematically precise"; they "contain arbitrary judgments as to allocation procedures and a wide margin of error in both data and methods utilized" (2 A. 630). Because of this "lack of precision" (2 A. 631), the Commission determined that, rather than attempting to choose a "precise" figure for each cost element, it would "express the general range within which rational choices can be made from reliable and credible data" (2 A. 635). Its objective

was to determine "the general limitations on the range or zone of reasonableness which the methodology allows us" (2 A. 639).

On the basis of this analysis, the Commission found a "range of reasonable costs of 4–5 cents per Mcf, among which one could rationally select a new gas cost" (2 A. 642).[22] The rate for new gas contained in the settlement proposal—26 cents per Mcf—"is within the zone of reasonableness of costs and in our judgment is at the appropriate level which will elicit exploratory and developmental effort in Southern Louisiana" (*ibid.*); it is the "just and reasonable rate" (2 A. 643). Since the rate it selected fell within the zone of reasonable costs, the Commission found it unnecessary to "quantify" the non-cost elements that might have expanded the upper limit of the reasonable range of new gas prices (*ibid.*).[23]

The court of appeals sustained the rate of 26 cents per Mcf. "We are convinced that this rate clearly falls within the 'zone of reasonableness' latitude which Courts must grant to FPC action" (Pet. App. 35). Since the 26 cents rate "clearly falls within the range of cost estimates which the evidence discloses," the Commission "properly declined to make what would

[22] "Cost" as used by the Commission includes a reasonable return on investment and a reasonable return on working capital (see 2 A. 635–636, 638, 640).

[23] It had earlier indicated that "no reliable quantitative forecasts may be made by increments of additional gas supply resulting from specific increased gas prices" (2 A. 623). "[P]recise quantification of the future supply response to prices" is "an impossible objective by any method" (*ibid.*).

be a necessarily speculative quantification of non-cost elements" (*id.* at 39).

Only Mobil here challenges the lawfulness of the new gas rate. It argues (Br. 59–63) that the Commission improperly failed to make upward non-cost adjustments in the price of new gas "to attract capital and to increase commitments for interstate sales" (Br. 60). It is true, of course, that "price can meaningfully be employed by the Commission to encourage exploration and production" (*Permian, supra,* 390 U.S. at 797). Indeed, the Commission stated that "price must have a major responsibility for eliciting new supplies" in Southern Louisiana (2 A. 601).

But new gas rates are only one element of the complex rate design adopted by the Commission. It does not stand alone as the only source of an effective incentive to elicit gas supplies. The Commission reasonably concluded that the total rate structure—including the flowing gas rates, the refund-credit program, and the contingent escalations program—"will attract additional capital to the exploration and development in Southern Louisiana" (2 A. 628). It also found that the new gas price of 26 cents would be an integral part of the rate incentives. "The additional resources from higher new gas rates * * * will also contribute to the total of needed capital" (*ibid.*).

Mobil has made no showing that the 26 cents rate, viewed as one element of the total rate structure, is "unjust and unreasonable in its consequences" (*Hope Natural Gas, supra,* 320 U.S. at 602). The Commis-

sion's plan of using contingent incentives to elicit supply, rather than relying exclusively on non-cost additions to the base rates, is an allowable exercise of its expert judgment.

Nor is there merit to Mobil's contention (Br. 61, 62) that the 26 cents rate is inadequate for producers who, like Mobil, have previously entered into rate and refund settlement agreements and who therefore will not benefit from the Commission's refund-credit program (see pp. 49–57, *infra*). The Commission recognized that the incentives in its rate order would not apply to all producers in an identical fashion. The rate structure is designed to function effectively for an entire producing area, covering many producers in varying circumstances, and the incentives are intended not as benefits or bonuses for producers but as inducements to enhance supplies for the consuming public.

Though one producer may incidentally benefit more than another—that is, in the court of appeals' words, one "may get icing on his cake" (Pet. App. 50)—the Commission reasonably concluded that no producer's rates would be unreasonably low—that is, none would be without "cake." If facts develop that show the contrary, however, and a producer can demonstrate that the effect of the rate structure in his circumstances is unreasonable, he may seek a special exemption from the area maximum base rate pursuant to the provisions of the Commission's order (2 A. 661).

2. Flowing gas.

Only Mobil attacks the base rate for flowing gas (*i.e.*, the rate for gas delivered after the effective date

of the Commission's order but pursuant to a contract dated prior to October 1, 1968).[24] The Commission found that the rates in the proposed settlement—22.375 cents per Mcf for onshore gas and 21.375 cents per Mcf for offshore gas—are "just and reasonable subject to the automatic and contingent escalations as provided herein" (2 A. 648).

It based that determination on a consideration of four "flowing gas cost studies" in the record (2 A. 644). The rates it chose were in excess of the cost figures on which it relied (21.18 cents per Mcf) (see 2 A. 647) and higher than the flowing gas rates established in *SoLa I*. The Commission reasoned that, since "[r]evenues from flowing gas * * * are an important source of funds for new investments by the producers" (2 A. 644), the flowing gas rate can be designed to stimulate exploration and development. It determined that "flowing gas realizations should bear a part of the responsibility for assuring a cash flow to meet the needs for a heightened exploration and production effort" (2 A. 645). The court of appeals expressly upheld that determination (Pet. App. 33) and sustained the flowing gas rate (*id.* at 34).

The difference between the cost figure of 21.18 cents and the chosen rate of 22.375 cents represents a non-cost factor designed to facilitate investment in exploration and development of new gas reserves. It was the absence of such a factor in the new gas rate that Mobil

[24] MDG and New York object only to the rates for gas delivered *prior* to the effective date of Opinion 598. Those are the rates that determine the level of refund obligations (discussed *infra*, pp. 41–48).

complained of. Here its argument is, in essence, that the non-cost addition is not enough.

Mobil complains that the Commission failed to make specific findings as to flowing gas costs (Br. 64–65). In reviewing the cost studies in the record, however, the Commission noted that, as in the case of new gas costs, there was a "range of estimates" that varied according to "choices implicit in the flowing-gas costing methodology" (2 A. 646). It looked principally to the staff's cost study—showing 21.18 cents per Mcf—as a starting point in determining the just and reasonable rate (2 A. 646–647). Though the Commission did not expressly find that costs are 21.18 cents per Mcf, it did accept the staff's analysis and recommendation that 22.375 cents per Mcf would be a just and reasonable rate and would include an adequate non-cost factor to stimulate exploration. The rate is not rendered invalid by the absence of an express finding as to the precise flowing gas cost level from among the range shown in the record. What matters is that the selected rate is within the zone of reasonableness accorded to the Commission.

Mobil's other contentions relate to the details of the Commission's methodology and the staff's cost study. It claims that the staff's cost study used an inadequate rate of return (Br. 65–66), that the true costs of flowing gas are 24 cents per Mcf (Br. 66), that "average unit revenues" for flowing gas will be inadequate under the Commission's plan (Br. 66–67), and that because of inflation the Commission's rate will not even cover actual costs (Br. 67).

But this Court is "not obliged to examine each detail of the Commission's decision" (*Permian, supra,* 390 U.S. at 767). Nor does it matter what method the Commission used in reaching its rate determination. "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling" (*Hope Natural Gas, supra,* 320 U.S. at 602). None of Mobil's arguments concerning the details of the flowing gas rate establishes that the "total effect of the rate order" is "unjust and unreasonable in its consequences" (*ibid.*). To the extent that cost increases, caused by inflation or otherwise, are not adequately provided for in the order's automatic escalation provisions (next discussed), adjustments in the rates may be sought from the Commission (see pp. 61–62, *infra*).

3. Automatic escalations.

The Commission's order provides for automatic escalations in the ceiling price of new and flowing gas. The new gas ceiling is to increase 1.0 cents per Mcf on October 1, 1974, about three years after the order's effective date; the flowing gas ceiling was to increase 0.5 cents per Mcf on October 1, 1973 (2 A. 592, 657). Though the Commission did not separately discuss these escalations in its opinion, it specifically found that its new and flowing gas rates are just and reasonable "subject to the automatic escalation provided herein" (2 A. 643; see 2 A. 648). The court of appeals stated that, in view of "the role of costs in FPC's determination of 'just and reasonable' rates for both flowing and new gas, * * * we hold that

these periodic escalations were a proper subject for the exercise of administrative discretion and clearly fall within that 'zone of reasonableness' which we allow FPC on review" (Pet. App. 50).

No party here challenges the automatic escalation in the price of new gas. MDG, however, claims that there is no support in the Commission's opinion or in the record for an escalation of the flowing gas rate (Br. 50–51). The Commission's opinion reflects its judgment, based on record evidence, that there exists an industry-wide need for large amounts of internally-generated capital (2 A. 624–626). The evidence showed that an investment of about $150 billion in exploration and development projects would be required by 1985 merely to prevent a further deterioration in the present critical gas supply situation (2 A. 625).

The Commission determined that part of the cost burden required to generate the funds for such investment should be borne by the rates for flowing gas (2 A. 645), and it was on this basis that it included a non-cost factor in the just and reasonable rate for flowing gas (2 A. 647–648). The Commission staff had recommended automatic escalations of one cent per Mcf in the base rates for new and flowing gas (4 A. 685) to account for increasing cost trends and the effects of inflation (4 A. 689–690). A witness estimated that the cost of finding and producing gas can be expected to increase at the rate of 2.5 percent per year and that "the need for internally generated funds would increase commensurately" (4 A. 692).

In light of that evidence, the Commission reasonably determined that, in addition to the contingent escalations of the flowing gas price, there should be an automatic escalation of one-half cent to take effect two years after the order's effective date. There is thus no substance to MDG's unfounded assertion that the automatic escalation "is there because the settlement negotiations put it there, and for no other reason" (Br. 51). The escalation was included in the just and reasonable flowing gas rate because the evidence showed that a price increase would be necessary to keep pace with increasing costs.

D. THE SCHEDULE OF PRODUCER REFUND OBLIGATIONS AND THE PROGRAM OF REFUND CREDITS FOR NEW DEDICATIONS OF GAS RESERVES FAIRLY ACCOMMODATE THE INVESTOR AND CONSUMER INTERESTS AND ENCOURAGE EXPLORATION AND DEVELOPMENT

1. The statute does not require the Commission to order refunds of amounts collected in excess of the just and reasonable rate.

Under Section 4(e) of the Act, 15 U.S.C. 717c(e), if a producer puts into effect increased rates that have been suspended by the Commission, the Commission "may * * * order such natural gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified." As the court of appeals correctly held, the Commission "does not *have* to order refunds under the terms of the Natural Gas Act. It *may* do so" (Pet. App. 43–44; emphasis in original). "The existence of the power * * * does not mean that its exercise is man-

datory * * *." *Public Service Commission of the State of New York* v. *Federal Power Commission,* 329 F. 2d 242, 250 (C.A. D.C.), certiorari denied *sub nom. Prado Oil & Gas Co.* v. *Federal Power Commission,* 377 U.S. 963. See, also, *In re Hugoton-Anadarko Area Rate Case,* 466 F. 2d 974, 990–991 (C.A. 9); *Mesa Petroleum Co.* v. *Federal Power Commission,* 441 F. 2d 182, 191 (C.A. 5); *Continental Oil Co.* v. *Federal Power Commission,* 378 F. 2d 510, 532 (C.A. 5).

Thus, contrary to the argument of MDG (Br. 42–44) and New York (Br. 32–34), where the Commission reasonably concludes that the payment of refunds, or of full refunds, would not serve the public interest, it is free under the Act to decline to order refunds or to order the payment of partial refunds. It has in fact reached such a conclusion on several occasions. See, *e.g., Hugoton-Anadarko Area Rate Proceeding,* 44 FPC 761, 779–780; *H. L. Hawkins,* 36 FPC 981; *George Despot,* 38 FPC 1041. The Commission's treatment of refunds in this case should be viewed in the light of its discretion to tailor refund obligations to the requirements of the public interest.

2. The amount of refunds ordered in this case is based on just and reasonable rate levels and represents a proper exercise of the Commission's discretion.

a. As the court of appeals correctly stated, the Commission "realized that refunding was a significant disincentive for current and future exploration and development and a possible impairment of the current capital situation of many companies" (Pet. App. 39). A staff witness testified that revenues collected for

past deliveries of gas, even though subject to refund, "were not excessive" and "should be retained for use in gas exploration and development by the industry irrespective of the rates collected by individual producers under individual contracts" (4 A. 693). He specifically recommended that "no refunds should be required" (4 A. 686).

The Commission could properly have determined, in these circumstances, that no refunds should be paid. But it adopted instead a program that ties the discharge of refund liabilities to the dedication of increased supplies of natural gas. It ordered that producer refund obligations be computed on the basis of newly-established just and reasonable rate levels for past delivery periods (2 A. 652–653) but that producers owing those refunds may discharge their obligations by dedicating new gas reserves to the interstate market (2 A. 654, 666). For each Mcf of newly dedicated reserves, a producer will receive a credit of one cent toward its total refund liability. In consequence, the consuming public will receive, for each penny collected by producers in excess of the just and reasonable rates for periods prior to the effective date of the Commission's order, either a refund of the penny or an Mcf of new gas supply.

Petitioners attack both the formula for computing the amount of refunds owed by producers and the plan to permit discharge of refund obligations through the dedication of new reserves. Although we treat the arguments separately, we emphasize that the formula and the discharge plan are integral parts of a single

refund program, just as the refund program itself is an integral part of the total rate structure.

b. The Commission's order in *SoLa I* had required producers to refund all amounts collected in excess of the rates prescribed in that order.[25] The total refund obligation was approximately $375 million (see 5 A. 237e). In the reopened proceedings, the Commission recognized that in determining the rate levels in *SoLa I* it had not taken proper account of evidence showing a deteriorating supply situation (2 A. 613). Its order "did not afford an adequate return and it understated the requirements for exploration and development" (2 A. 653). In *SoLa II*, the Commission's rate scheme was designed to stimulate and facilitate capital investment in exploration and development. The Commission determined that the internally-generated capital to be made available through the new rate structure should not be diminished by requiring producers to pay out immediate refunds (2 A. 629).

The Commission revised upward the rate levels for gas delivered prior to August 1, 1971 (2 A. 652–653; see p. 9, n. 8, *supra*). For gas delivered prior to January 1, 1965, the level chosen as a refund floor corresponds to the approved settlement rate in prior cases in the Southern Louisiana area. See *Union Texas*

[25] Because maximum just and reasonable rates had not been established for the Southern Louisiana area prior to the Commission's order in *SoLa I*, rates for a substantial portion of the gas that had been sold in the area had been collected subject to refund under Section 4(e) of the Act, 15 U.S.C. 717c(e). The *SoLa I* rates are set forth at 2 A. 653, n. 140.

Petroleum, 32 FPC 254, 305. The price level for deliveries made between January 1, 1965, and September 30, 1968, corresponds to the guideline price that had been established for initial sales in Southern Louisiana. See *Fourth Amendment to Statement of General Policy No. 61–1,* 26 FPC 661, 662. For deliveries between October 1, 1968, and January 1, 1971, the Commission established a percentage formula for determining refunds based on the *SoLa I* rate levels, rather than establishing a new rate for that period. For deliveries after January 1, 1971, refunds are to be calculated on the basis of the new and flowing gas base rates established in *SoLa II.*

The refund formula was adopted in its entirety from the proposed settlement, and the Commission deliberately left some flexibility in the formula in order to bring the total refund figure to approximately $150 million (2 A. 662), the amount that had been settled upon in negotiations leading to the settlement proposal. The Commission expressly found that each of the refund rate levels is "reasonable and in the public interest" and that the entire refund formula is "just and reasonable" (2 A. 654). The court of appeals fully sustained the formula, stating that the Commission "is empowered to adopt a schedule or structure of refunds which it, in its administrative discretion and expertise, believes will fairly balance the interests of both consumers and producers while achieving the overriding public interest, that interest in the 1970's being the quest for an increased supply to meet an insatiable demand" (Pet. App. 44).

c. MDG and New York insist on characterizing the Commission's refund structure in *SoLa II* as an "elimination" (MDG 24) or "forgiveness" (NY 18) of the refunds established in *SoLa I*. Their characterization rests in part on their view that the reopening of *SoLa I* was impermissible and that the new rate structure is therefore retroactive in effect (see MDG 14–23). We have already shown (pp. 18–25, *supra*) that the Commission properly reopened the proceedings and that its revision of the *SoLa I* rate structure, which had not been finally approved, was not "retroactive."

The Commission did not in fact "forgive" refunds in *SoLa II*. It determined, in the light of new evidence concerning the deteriorating supply situation and the need for internally generated capital to facilitate exploratory activity, that the refund obligations of *SoLa I* were unreasonably high and would unduly diminish producers' "available capital" (2 A. 629). This reassessment of the public interest, regardless of the label petitioners attach to it, was a reasonable and proper exercise of the Commission's regulatory authority.

MDG argues that the Commission's reasoning is defective because the order gives no assurance that the "available capital" will be used by producers to finance exploratory activity (Br. 38–41). The Commission, however, found "it unlikely that producers, already involved in the Southern Louisiana area, will decide not to expand their exploratory and drilling effort" (2 A. 648). Its judgment is supported in the

record. Staff witness Engel testified that it is reasonable to expect the industry to use available capital in the search for new gas reserves (4 A. 695). "[A]vailable data reveals that the industry's revenues have historically been plowed back into further exploration, development, and production operations" (*ibid.*). "[T]here can be no doubt that the industry will endeavor to maintain and increase its stake in this vital energy source" (4 A. 696).

Both MDG (Br. 33–36) and New York (Br. 22–23) disagree with the Commission's judgment that the public interest would be served by permitting producers to retain capital for exploration and development rather than requiring it to be expended on refunds. They believe that the capital generated by the base rates for new and flowing gas is adequate by itself and that there is no need further to "subsidize revenues from gas still to be discovered in the future" (MDG 33).

But the Commission's order does not "subsidize" future revenues. It permits greater use of existing funds in the search for new gas instead of in the repayment of rates collected for past deliveries. While petitioners may have a different view of the proper way to balance the competing interests at stake, the Commission reasonably concluded that the refund plan it adopted would best serve the public interest. The base rates are, of course, also designed to provide needed funds for exploratory activity. But they are not meant to stand alone, and there is no requirement that they do so (see Pet. App. 44).

Petitioners' belief that the base rates are themselves sufficient to generate capital and that "[n]othing more could possibly be needed" (MDG 35) should be, and indeed was, addressed to the Commission, for that is plainly a matter for the Commission's expert judgment. The refund plan established by the Commission, reflecting its judgment that the payment of refunds should not be permitted to undercut the benefits of the other elements of the rate structure, has not been shown by petitioners to be unjust or unreasonable.[26]

Petitioners' remaining arguments relate only to the details of the refund plan. MDG challenges the Commission's finding that the rate levels in *SoLa I* did not provide an adequate return (Br. 25–26), and disputes the Commission's use of a "direct assignment" rather than a "modified BTU" method in allocating exploration and development expenses (Br. 26–32). But the Commission found, in the light of additional evidence of the industry situation and public needs, that the "zone of reasonableness of rate of return is within the range of 13 percent to 16 percent" (2 A. 636); the *SoLa I* rates were based on a rate of return of 12 percent. The Commission's determination to use a new

[26] MDG claims (Br. 36–37) that it is unlawful to require gas consumers to contribute to capital. If this means that the Commission is limited to establishing ceiling rates on the basis of cost alone, it is contrary to the settled principle that price may be employed functionally to encourage and facilitate exploration and production (*Permian*, *supra*, 390 U.S. at 797–798). The Commission reasonably concluded, in the proper exercise of its regulatory authority, that the refund plan should be tailored to avoid diminishing the capital available for exploration and development of reserves.

method of cost allocation for exploration and development expenses was based on the recommendation of its staff and did not result in refund rate levels that fall outside the "range of estimates" that are "implicit in flowing-gas costing methodology" (2 A. 646). The Commission's choice of a costing method is properly a matter for the application of its expertise. Since the "result reached" is within the zone of reasonableness, it is not necessary to consider whether the "method employed * * * may contain infirmities" (*Hope Natural Gas, supra,* 320 U.S. at 602).

New York takes issue with the particular refund rate levels chosen by the Commission (Br. 26–30). But in view of the imprecision of cost determinations—producing in the context of new gas a "range of reasonable costs of 4–5 cents per Mcf" (2 A. 642)—it cannot be said that the levels selected by the Commission were outside the permissible zone of reasonableness. Nor is it improper for the Commission to set the refund rate levels with an eye toward the figure for total refund obligations contained in the settlement proposal. The Commission properly took account of the balance of interests reflected in the proposed settlement and determined that total obligations of $150 million were just and reasonable. That it left the refund formula flexible to approximate that figure is not impermissible.[37]

[37] We note also that, if the Commission had applied its 22.375 cents flowing gas rate to past deliveries, as it did in the Permian Basin area proceedings (34 FPC 159, 232–233), the amount of refunds would have been substantially smaller (see Pet. App. 43).

3. The refund-credit plan is not unduly discriminatory and is a reasonable means of encouraging the dedication of new reserves to the interstate market.

The Commission's order permits producers owing refunds to discharge their obligations through the dedication of new gas reserves to the interstate market, receiving a one cent credit for each Mcf so dedicated (2 A. 666).[28] If new commitments to a particular purchaser exceed the amount necessary to discharge the refunds owed to that purchaser, the additional dedications shall be used to reduce refund obligations owed to other purchasers on a proportional basis (2 A. 666–667). No more than half of the refunds owed to a particular purchaser, however, may be reduced in that manner, unless the purchaser rejects a written offer of new dedications, in which case the rejected reserves may be used to reduce the refunds owed to the purchaser even though they are sold to another purchaser (*ibid.*). If a producer's refund obligations are not fully discharged by October 1, 1977, it must pay the remaining obligations in cash with interest from August 1, 1971 (2 A. 667).[29]

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[28] Producers must formally elect to participate in the refund-credit plan by filing a notice with the Commission within three months of the order's effective date (2 A. 666). A producer who does not so elect is required to retain the amounts owed "subject to further order of the Commission directing the disposition of those amounts" (*ibid.*).

[29] In its order denying rehearing, the Commission made provision for a possible one-year extension of the 1977 deadline, on a showing that, as of August 1, 1976, a producer has discharged 65 percent of its refund obligations or "has made a sincere and diligent effort to so discharge" (2 A. 879).

This refund-credit plan was chosen by the Commission in place of its staff's recommendation (see pp. 41–42, *supra*) that no refund obligations be imposed at all. It is designed to ensure, as we indicated above, that the nation's gas consumers receive for each penny collected above the just and reasonable rates for past deliveries either a cash refund or an additional Mcf of new gas supply. The Commission reasonably concluded, consistent with its authority under Sections 4(e) and 16 of the Act, 15 U.S.C. 717c(e) and 717*o*,[30] that this plan would best serve the public interest by encouraging the dedication of new gas supplies to the interstate market. It found that "such an incentive will be of net benefit to the consumer," who will thereby obtain "additional gas supplies" (2 A. 654).

Petitioners' objections to the refund-credit plan are essentially two: (1) it is unduly discriminatory and preferential, because it disadvantages existing producers who have entered into rate settlement agreements and new entrants who have no refund obligations to discharge; and (2) it does not give sufficient assurance that the purchasers to whom the refunds are owed will be the beneficiaries of the new dedications used to discharge the refunds.[31]

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[30] Section 16, 15 U.S.C. 717*o*, empowers the Commission to take any action that "it may find necessary or appropriate to carry out the provisions of" the Act.

[31] Mobil also argues that the plan is not supported by substantial evidence (Br. 54–56) and that there are reasonable alternatives to accomplish the Commission's objectives (Br. 56–57). But Mobil has not shown that the court of appeals "misapprehended or grossly misapplied" the standard (*Uni-*

a. The argument that the plan is unduly discriminatory (Mobil 35–38, 44–53; MDG 46–49, NY 41–43) proceeds in this way. Some producers in the area are parties to settlement agreements or have otherwise discharged all or most of their potential refund liabilities. Since they will not have dischargeable obligations, they will not be in a position to benefit from the refund-credit plan. The effect, petitioners contend, is that those producers who have collected the highest rates in the past and who have not settled or otherwise discharged their liabilities will receive an extra penny of revenue for each Mcf of gas newly dedicated to the interstate market. Similarly, they argue, a new entrant will be disadvantaged because he, too, lacks refunds to discharge and will not benefit from the one cent credit available to producers owing refunds.

Petitioners err in characterizing the refund-credit plan as affording additional revenues to producers who owe refunds. The design and effect of the plan

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versal Camera, *supra*, 340 U.S. at 491) in finding that the provisions of the Commission's order are "amply supported by 'substantial evidence on the record as a whole'" (Pet. App. 30). The existence of other means to accomplish the objectives sought by the Commission does not, of course, mean that the method chosen by the Commission is impermissible. In addition, New York argues (Br. 41) that no refund-credit incentive is needed to induce producers to dedicate offshore reserves to the interstate market, because all gas from the offshore areas in the federal domain are necessarily in interstate commerce. But the refund-credit plan, like the other incentives in Order No. 596, is not designed solely to attract to the interstate market gas that would otherwise be sold in the intrastate market. It is also designed to encourage the immediate development of reserves that might otherwise be deferred for later development.

is not to provide unequal revenues to producers but to permit all producers equally to invest the capital generated by the newly established base rates in further exploration and development activities rather than in refund payments. The plan does not add to current revenues; it makes it possible to avoid reductions in capital generated from current revenues.

The Commission recognized, however, that the plan would comparatively disadvantage those producers "who have attempted to work 'within the system'" (2 A. 600), and we do not deny that the plan may permit producers who have collected the highest rates in the past to retain the amounts collected in excess of the just and reasonable rates for past periods. The Commission acknowledged that some "inequities" (*ibid.*) may occur. But it reasonably concluded that any area rate scheme would contain some inequities and that the overall benefits of this plan for the consuming public outweigh its disadvantages (2 A. 601).

The Commission's regulatory task of ensuring an adequate supply of natural gas at a reasonable price requires the Commission to design its area rate orders with a view principally to their ultimate impact on supply and price. Minor inequities or infirmities are sometimes unavoidable; but, so long as they do not result in unreasonably low or confiscatory rates for any producer, they do not invalidate an otherwise proper and effective rate design.

Moreover, as the court of appeals indicated (Pet. App. 47, n. 31), the disparities in this case are a consequence of voluntary undertakings by some pro-

ducers to compromise on rates and refunds. The settlement agreements that those producers entered into provided for the forgiveness of substantial amounts that were then assumed to be owing in refunds, and to that extent those who settled have already received pursuant to contract some of the same "benefits" that the Commission has now provided for by order.

In agreeing to the terms of a settlement, the producers presumably anticipated that the agreement would be beneficial to them because its provisions would be more favorable than the terms of the Commission's ultimate order. At the same time, however, they necessarily assumed the risk that the Commission would ultimately establish just and reasonable rates higher than the settlement level, and that the agreement therefore would not be advantageous. Such risks and potential benefits are, of course, common in contractual undertakings. That the Commission prescribed just and reasonable rates higher than the producers anticipated, and provided for refund obligations dischargeable by dedications of reserves rather than by cash payments, may make their bargains seem less advantageous in retrospect, but it "furnishes no basis for attack" upon the refund discharge plan (Pet. App. 47, n. 31).

If the Commission had in fact required the payment in cash of substantial refunds, many of those producers may have been in a comparatively better position, as a consequence of their settlements, than those who had not settled. Surely that would not have amounted to impermissible discrimination against

producers who were not parties to a settlement agreement. The corollary is also true. The disparities of the refund-credit program result from voluntary contractual undertakings and are not impermissible under the Natural Gas Act.

The evidence before the Commission could have justified a determination that no refunds should be paid (see pp. 41–42, *supra*). The logic of petitioners' argument would require them to say that even that determination would have been improper, because some producers would, in effect, have been permitted to collect rates for past deliveries that are higher than the rates called for by other producers' settlement agreements. To state the argument is to answer it. The Act does not require the Commission to establish rates that are in harmony with those agreed upon in approved settlements.

The Commission did not here follow the course of refusing to order refunds. But the effect of its plan is similar for producers who in fact discharge their obligations by dedicating new natural gas reserves to the interstate market. They will, in effect, have been permitted to collect and retain rates for past deliveries that are higher than the rates in some settlement agreements. The only difference is that their right to retain those amounts will be established over the course of several years instead of automatically upon the issuance of the Commission's order. That difference does not make the discharge plan unlawfully discriminatory.

b. To argue that new entrants will suffer impermissible discrimination is another way of arguing that the Commission may never depart from costs in establishing just and reasonable rates for gas delivered in the past or for flowing gas to be delivered in the future. If the Commission were to take into account, in prescribing those rates, the needs of existing producers for capital to invest in exploration and development, and if it were to include an appropriate non-cost factor in the rate, the claim could be made that new entrants are disadvantaged because they will not be the beneficiaries of that non-cost rate factor.

The Commission's regulatory authority is not so restricted. The fact is that new entrants are not identically situated to established producers. The Commission is not limited, in designing its rate structures, to using only those inducements and incentives that can be directed to *all* classes of producers. The important considerations are whether a particular plan is likely to be effective in eliciting new supplies at a reasonable price, and whether all producers are assured reasonable rates.

Under the Commission's order in this case, new entrants will be able to collect 26 cents per Mcf, the highest base rate, for all their gas reserves. They will not be in a position, of course, to discharge refunds of amounts previously collected, but that is only because they were not then in business. Though existing producers may consequently be able to retain for investment purposes past revenues that the new entrant

does not have available to him, that would also be true in the absence of the refund-credit program. The existing producers, by virtue of their prior sales of natural gas, may well be in a better capital position than a new entrant. These are the hurdles that a new entrant faces in any industry.

There is no reason to believe that new entrants will be deterred from entering the natural gas producing industry simply because existing producers may be able to retain for investment purposes amounts collected for past deliveries.[22]

c. Petitioners also argue (NY 40–42; MDG 47) that the refund-credit plan is unlawful because it allows a producer to discharge up to 50 percent of his refund obligations to a particular purchaser through dedications of gas to other purchasers. A 100-percent rule, however, would give pipelines with large refund rights an undue advantage in bidding for new gas reserves and might induce individual producers to confine their search for gas to areas in the vicinity of the pipelines to whom they owe refunds. A zero-percent rule, on the other hand, would give purchasers from whom the excessive rates were collected no preference in obtaining the new gas supplies that are dedicated in lieu of the cash refunds.

The court of appeals correctly concluded that the 50-percent rule "is amply supported by the credible evidence" and "fairly balances the interests of the

[22] Indeed, the Commission believed that the "new stability" provided by its rate structure in *SoLa II* would "furnish the climate to reduce producer uncertainty and attract new entrants" (2 A. 629).

producers with those of the consumers" (Pet. App. 40, n. 26).

E. THE PROVISION FOR CONTINGENT ESCALATIONS OF THE PRICE OF THE FLOWING GAS IS A REASONABLE INCENTIVE FOR NEW EXPLORATION AND IS NOT UNDULY DISCRIMINATORY

The Commission's order provides for three half-cent increases in the ceiling price of flowing gas, to be triggered when new area-wide dedications prior to October 1, 1977, reach the levels of 7.5 Tcf, 11.25 Tcf, and 15 Tcf (2 A. 648–649, 658). A producer's new dedications will be applied first to the reduction of any outstanding refund obligations; only dedications not so applied will be counted toward the area-wide targets (2 A. 649, 658).

1. This contingent escalations plan is challenged on several grounds. First, MDG (Br. 51–52) and New York (Br. 36) claim, in effect, that the levels will be too easily reached. But that is a matter for the Commission's expert judgment, based upon its knowledge of the industry and the producing area. An otherwise reasonable incentive program is not to be upset simply because some parties take a different view of what the level of incentive should be.

2. New York (Br. 36) disagrees with the Commission's "basic theory that increases in flowing gas rates are necessary or even useful in enhancing the producer's future exploratory and development activities * * *." The Commission found, however, on the basis of substantial evidence, that "[r]evenues from flowing

gas * * * are an important source of funds for new investments by the producers" (2 A. 644).

3. MDG (Br. 51–52) and New York (Br. 35–37) contend that the Commission failed to consider the need for the contingent escalations and failed to justify the specific levels of dedications chosen as triggers for the escalations. The Commission did find, however, (1) that there is "a critical shortage of gas in the United States" (2 A. 606), (2) that, though it cannot be precisely quantified, "there is a strong positive relationship between price and supply, particularly in the sense of a positive relationship between price and exploratory effort" (2 A. 620), (3) that "[f]lowing gas resources represent an important source of capital to the industry" (2 A. 628) and "flowing gas realizations should bear a part of the responsibility for assuring a cash flow to meet the needs for a heightened exploration and production effort" (2 A. 645), and (4) that "[a] portion of the funds required for further exploration and development in Southern Louisiana will be generated by the increased cash flow * * * from the operation of the contingent escalation provisions" (2 A. 628).

These findings relate directly to the need for the contingent escalations and the anticipated benefits. The Commission did not attempt to quantify the amounts of new gas that the particular incentive levels would stimulate, because it found such quantification to be "impossible" (2 A. 623). It relied instead on its "informed judgment" with respect to "the influence of price on supply" (2 A. 620), and it recog-

nized that the correctness of that judgment could only "be determined by continued Commission observation of the results of our decisions" (2 A. 624).

We note, moreover, that the evidence in this case would have supported three automatic half-penny escalations to account for anticipated cost increases (see pp. 39–40, *supra*). In these circumstances, the Commission was justified in making the escalations contingent in order to provide an industry-wide incentive for new dedications.

4. MDG (Br. 53) and New York (Br. 37–38) next argue that, like the refund-credit plan, the contingent escalations unduly discriminate against new entrants, since they have no flowing gas to which the escalations would apply. But, as we showed earlier in this brief, any producer rate plan that takes capital needs into account in the context of flowing gas necessarily "disadvantages" the new entrant. The Commission is not required to avoid an otherwise proper and effective rate design simply because it includes incentives based on flowing gas rates. Moreover, since flowing gas revenue is an important source of investment capital for producers, the new entrant would be somewhat disfavored regardless of the contingent escalations. The additional disadvantage occasioned by the contingent escalations is minimal.

5. Mobil (Br. 47–49) and MDG (Br. 53) complain that the consequence of the Commission's order is to require some producers to "put more money in the pockets of [their] competitors" (MDG 53). They argue that it is unfair and discriminatory to permit a

producer whose new dedications have been counted only toward the discharge of his own refund obligations to enjoy the benefits of a contingent price escalation that is triggered by the dedications of new entrants (who cannot enjoy the increase at all) and existing producers without refund obligations.

But this is just another way of arguing that the refund-credit plan is impermissibly discriminatory, an argument we have already answered (pp. 51–54, *supra*). The Commission is not required, in an area rate plan, to tailor its industry-wide incentives to each producer separately. "[T]he public interest is here concerned with total dedications of gas in the magnitude of several trillion cubic feet from all sources, not with target objectives for each producer" (2 A. 874).

As for new entrants, they will be receiving more for their gas (26 cents) than any existing producer will be receiving for his flowing gas even if all the automatic and contingent escalations are triggered (24.375 cents). As the court of appeals stated, "we fail to see why [the new entrant] would be in the least bit dissuaded from committing new reserves at 26¢/Mcf by the fact that it might allow some of his competitors to raise their 22.375¢/Mcf flowing gas price by a half-penny" (Pet. App. 51).

6. New York suggests (Br. 39) that the Commission's plan will permit a producer to benefit from the flowing gas price escalation even if he engages in no new exploration. But the Commission found, on the

basis of substantial evidence (see p. 46, *supra*), that producers probably will "expand their exploratory and drilling effort" (2 A. 648).

7. There is, finally, no merit to the contention (NY 38) that those who pay the increased price for flowing gas must be afforded a proportional amount of the new supplies generated by the plan. Even apart from the practical difficulties of administering such an allocation program, the Commission may properly take a broader view of the public interest. The important objective was to obtain new supplies for the interstate market. If it develops that the cost burdens are inequitably distributed, and if those inequities do not disappear with time, the Commission has the power to take the necessary corrective measures.

F. THE COMMISSION'S MORATORIUM ON RATE INCREASES, ITS TREATMENT OF ROYALTY ALLOWANCES, ITS PRICE FOR CASINGHEAD GAS, AND ITS MINIMUM RATES FOR LIQUID AND LIQUEFIABLE HYDROCARBONS ARE REASONABLE AND PROPER

Petitioners' remaining contentions raise no substantial issues.

1. *Moratorium.* Mobil argues (Br. 71–75) that the moratorium on filing rate increases is improper because, unlike the situation in *Permian, supra,* the record in this case shows that costs are rising. But the Commission's rate plan contains automatic and contingent price escalations that are designed in part to take account of increasing costs. A producer is, of course, free to seek an exemption from the mora-

torium or the maximum area rate if he can justify the relief he seeks in light of the Commission's opinion (2 A. 661). Other methods are available to deviate from the area ceiling rates (see Pet. App. 59–61).

In these circumstances, the Commission properly imposed a rate-increase moratorium to lend stability to the *SoLa II* rate structure. The court of appeals correctly held that the moratorium is "an appropriate exercise of administrative discretion supported by 'substantial evidence on the record as a whole'" (Pet. App. 52).

2. *Royalty payments.* Mobil argues (Br. 81–84) that the Commission improperly treated royalty payments as a fixed percentage of total costs, because some producers *may* be required to pay royalties on the basis of higher values. The court of appeals correctly concluded that the issue is hypothetical at this stage and that if it becomes a reality producers may seek special relief from the Commission (Pet. App. 56).

3. *Casinghead gas.* New York contends (Br. 43–45) that the Commission improperly authorized the sale of casinghead gas (*i.e.,* gas produced in association with the production of oil) at the same price as gas-well gas. Although casinghead gas costs less to produce than gas-well gas, the evidence before the Commission indicated that substantial volumes of casinghead gas were being flared (*i.e.,* burned) in the Southern Louisiana area, because it was uneconomical at current prices to install the necessary compression facilities (4 A. 694–695).

It was to prevent flaring and to avoid diversion to the intrastate market that the Commission eliminated the price distinction between casinghead and gas-well gas (2 A. 651, 871). The court of appeals properly upheld the determination as "within the bounds of administrative propriety" (Pet. App. 53). New York disagrees with the Commission's factual assessment, but it has not demonstrated any legal error.

4. *Liquid and liquefiable hydrocarbons.* The Commission adopted mandatory minimum rates for the transportation by a pipeline of liquid or liquefiable hydrocarbons (2 A. 650–651). Mobil argues (Br. 75–80) that the Commission's determination is not supported by substantial evidence.[33] But the court of appeals "examined the testimony regarding this matter" and concluded that the Commission "had a substantial evidentiary basis from which it could conclude that the particular rates which it established should supply a reasonable floor on these charges" (Pet. App. 57). Mobil has not shown that the court "misapprehended or grossly misapplied" the substantial evidence standard (*Universal Camera, supra,* 340 U.S. at 491).

[33] In *Mobil Oil Corp.* v. *Federal Power Commission*, 483 F. 2d 1238 (C.A.D.C.), the court held that the Commission has jurisdiction over the transportation of liquefiable hydrocarbons, but that it does not have jurisdiction over the transportation of *liquid* hydrocarbons, at least on a record which does not show that "rate jurisdiction over liquids is necessary to preserve its rate jurisdiction over natural gas" (483 F. 2d at 1249). Mobil has not challenged the Commission's jurisdiction in this case.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

The Natural Gas Act, 52 Stat. 821, *et seq.*, as amended, 15 U.S.C. 717, *et seq.*, provides in pertinent part:

Section 4, 15 U.S.C. 717c:

RATES AND CHARGES; SCHEDULES; SUSPENSION OF NEW RATES

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and

charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but

not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 5, 15 U.S.C. 717d:

FIXING RATES AND CHARGES; DETERMINATION OF COST OF PRODUCTION OF TRANSPORTATION

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, ob-

served, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increases is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission, whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such natural gas.

Section 16, 15 U.S.C. 717*o*:

ADMINISTRATIVE POWERS OF COMMISSION; RULES REGULATIONS, AND ORDERS

The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this Act.

Among other things, such rules and regulations may define accounting, technical, and trade terms used in this Act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

Section 19, 15 U.S.C. 717r:

REHEARINGS; COURT REVIEW OF ORDERS

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(b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the Untied States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith

be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

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